IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 77 of 1992

For Approval and Signature:

HON'BLE MR.JUSTICE M.S.SHAH
and
HON'BLE MR.JUSTICE A.M.KAPADIA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

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HIMSON TEXTILE ENGG INDUSTRIESPVT LTD

Versus

COMMISSIONER OF INCOME TAX

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Appearance:

1. INCOME TAX REFERENCE No. 77 of 1992
MR RK PATEL for Petitioner No. 1
MR MANISH R BHATT for Respondent No. 1

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CORAM : HON'BLE MR.JUSTICE M.S.SHAH
and
HON'BLE MR.JUSTICE A.M.KAPADIA

Date of decision: 22/01/2004

ORAL JUDGEMENT

(Per : HON'BLE MR.JUSTICE M.S.SHAH)

In this reference at the instance of the assessee, the following question of law has been referred for our opinion in respect of the assessment year 1982-83:-

"Whether on the facts and in the circumstances of the case, the Tribunal is right in coming to the conclusion that the amount of Rs.1,18,920/- representing income tax liability of the erstwhile firm and paid by the assessee company cannot be allowed as deduction as an expenditure while computing the taxable income in the hands of the assessee?"

2. We have heard Mr RK Patel, learned counsel for the assessee and Mr MR Bhatt, learned Standing Counsel for the revenue.

3. The assessee claimed deduction of a sum of Rs.1,18,920/- in respect of income tax liability of the erstwhile partnership firm styled as M/s.Himson Textile Engineering Industries. The assessee company joined as a partner in the aforesaid partnership firm which was dissolved on 31st December, 1979. A deed of dissolution was executed between the partners of the said firm on 31st December 1979 in which it was inter-alia agreed that the assessee company which was one of the partners of the said firm has taken over all the assets and liabilities of the said firm as a going concern. It was contended on behalf of the assessee before the learned CIT (Appeals) that since the assessee company had undertaken to pay all the liabilities of the erstwhile firm, it had to make one such payment by way of income tax of the erstwhile firm. The payment of income tax liability of the predecessor concern should be allowed as a deduction in computation of taxable income in the hands of the assessee. The CIT (Appeals) accepted the assessee's contention on the ground that such tax liabilities were of the predecessor firm and not of the appellant company. Hence the same is allowable in view of judgment of Hon'ble Supreme Court in the case of T.V.K. Koteshwararao 155 ITR 152.

The revenue preferred appeal before the Income Tax Appellate Tribunal which analysed the relevant provisions and also considered the decisions of the Hon'ble Supreme Court in T.V.K. Koteshwararao 155 ITR 152, and the decision of the Punjab & Haryana High Court in Dashmesh Transport Co. Pvt. Ltd. 93 ITR 275 and the

decision of the Madhya Pradesh High Court in Shriram Prayagdas & Mahadeo Prasad 144 ITR 883 relied upon by the assessee and held that the CIT (Appeals) erred in allowing the aforesaid deduction of Rs.1,18,920/- and directed the ITO to disallow the same while computing the taxable income in the hands of the assessee company. The Tribunal distinguished the aforesaid decisions relied upon by the assessee and held that income tax is a personal liability and all the partners of the firm are jointly and severally liable for paying such income tax. The assessee was one of the partners of the erstwhile firm and at the time of dissolution, the assessee company undertook to make payment of all the liabilities of the erstwhile firm. Hence the assessee had paid the amount of income tax as a part of the consideration for acquiring the running business of the erstwhile firm along with its assets and labilities and accordingly the amount can only be regarded as capital expenditure in the hands of the assessee.

4. Mr RK Patel, learned counsel for the assessee submitted that the decision of the Madhya Pradesh High Court in CIT vs. Shriram Prayagdas & Mahadeo Prasad, 144 ITR 883 clinches the issue because it has been held therein that the question whether the assessee was bound to pay the income tax dues of its predecessor was immaterial and that in view of the said ratio laid down by the Madhya Pradesh High Court, the assessee is entitled to claim the deduction. Mr Patel also submitted that the nature of the liability of the income tax of the erstwhile firm changed when the assessee took over the running business and, therefore, what was not deductible in the hands of the erstwhile firm became deductible in the hands of the assessee.

5. Mr MR Bhatt, learned Standing Counsel for the revenue has supported the judgment of the Tribunal and relied upon the following decisions:-

(i) Dashmesh Transport Co. (P.) Ltd. vs. CIT, 125 ITR 681 (Punjab & Haryana High Court)

(ii) Puspa Perfumery Products Pvt. Ltd. vs. CIT, 194 ITR 248 (Calcutta High Court)

(iii) Industrial Credit and Development Syndicate Ltd. vs. CIT, 196 ITR 574 (Karnataka High Court)

(iv) CIT vs Hyderabad Race Club, 249 ITR 391 (Andhra Pradesh High Court)

6. Before referring to the decisions cited by the learned counsel at the Bar, it is necessary to refer to the relevant provisions of Section 40 of the Act which expressly provide as under:-

"40. Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession", -

(a) in the case of any assessee -

(i) ... .... ... ... ...

(ii) any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains;

The aforesaid categorical language of Section 40 leaves no room for doubt that the income tax paid is not deductible and the section does not make any distinction between the income tax paid by the assessee on its own income and the income tax paid by the assessee on the income of the predecessor.

7. At this stage, reference is required to be made to the decision of the Apex Court in CIT vs. TVK Koteswara Rao, 155 ITR 152. Although that case pertained to allowability of deduction of bad debt and the question was decided in favour of the assessee, the following observations made by the Apex Court are relevant :-

"If a business, alongwith its assets and liabilities, is transferred by one owner to another, we see no reason why a debt so transferred should not be entitled to the same treatment in the hands of the successor. The recovery of the debt is a right transferred along with the numerous other rights comprising the subject of the transfer. If the law permits the transferor to treat the whole or part of the debt as irrecoverable and to claim a deduction on that account, it seems difficult to accept that the same right should not be recognized in the transferee. It is merely an incident flowing from the transfer of the business, together with its assets and liabilities, from the previous owner to the transferee. It is a right which

should, on a proper appreciation of all that is implied in the transfer of a business, be regarded as belonging to the new owner."

What is enunciated regarding the rights taken over by the successor will apply equally to the liabilities taken over by the successor including the liability to pay income-tax of the predecessor.

8. The issue arising in the present reference has been directly considered by the Calcutta High Court in Puspa Perfumery Products Pvt. Ltd. vs. CIT (1992) 194 ITR 248 and it has been held as under:-

" ... In our view, whatever is not deductible in the hands of the transferor as a trading liability cannot be allowed as a deduction in the hands of the transferee. By reason of the transfer of the assets and liabilities of the business, the nature and character of the liability cannot change. The plain words of section 40 have to be given effect to. So long as the liability is income-tax liability, no matter how and under what circumstances it is paid and by whom, the persons paying it cannot claim it as a permissible deduction. In whatever language it is couched, tax liability is a tax liability and can assume no other character. It is immaterial whether such tax liability was a part of the purchase consideration or not. It is true that section 170 provides that the tax liability, when a business is transferred prior to the date of transfer, rests with the transferor and, after the date of transfer, rests with the transferee. The transferee may be made liable for the liability of the transferor but, if the transferee discharges such liability, it cannot be said that such payment has been made for the preservation and protection of the assessee's business from any process or proceedings which might have resulted in the reduction of its income and profits. In any event, this liability was not incurred by the assessee in the conduct of its business. ..."

In the aforesaid decision, the Calcutta High Court has also dealt with the contention based on the decisions of the Madhya Pradesh High Court in CIT vs. Shriram Prayagdas & Mahadeo Prasad, 144 ITR 883 and of the Punjab & Haryana High Court in Dashmesh Transport Co. P. Ltd. 93 ITR 275. While the decision of the Madhya

Pradesh High Court was distinguished by the Calcutta High Court, the decision of the Punjab & Haryana High Court was dissented from and reference was made to the subsequent decision of the Punjab & Haryana High Court in Dashmesh Transport Co. P. Ltd. 125 ITR 681. The Calcutta High Court then concluded that apart from the fact that the tax liability is not deductible where the assets and liabilities are taken into account for ascertaining the purchase consideration, the liabilities in effect reduce the purchase consideration. In other words, the liabilities form part of the purchase consideration.

We are in respectful agreement with the views of the Calcutta High Court.

9. We may further deal with the submission made by Mr Patel for the assessee that the Madhya Pradesh High Court has laid down that the question whether the assessee was bound to pay the income tax dues of the erstwhile firm is immaterial.

In our view, that is not the correct reading of the ratio laid down by the Madhya Pradesh High Court in Shriram Prayagdas & Mahadeo Prasad (supra). In the facts of that case, the Court held that the assessee was not liable to pay the income tax dues of its predecessor firm and it was in order to get the buses attached by the Government released that as a commercial expediency the assessee paid up the income tax dues of its predecessor because the possession of the buses by the assessee was absolutely necessary for carrying on its business and the commercial expediency accordingly required the payment of income tax dues for the release of its buses so that the assessee may carry on its business. Thereafter, the Madhya Pradesh High Court made the following observation:-

> "It is immaterial here that the assessee was not bound to pay the income tax dues of the United Transport Company (the predecessor firm)."

It is important to note that because the assessee was not bound to pay the income tax dues of the predecessor firm, the Madhya Pradesh High Court allowed payment of the tax liability of the predecessor firm to the assessee on the ground of commercial expediency but the converse is not true, that is to say, that where the assessee is bound to pay the income tax dues of the predecessor firm there can be no question of considering the deductibility of such payment.

10. In the facts of the instant case, the Tribunal has given an additional reason to support its decision that the assessee was one of the partners of the erstwhile firm and the assessee had agreed to take over the tax liabilities of the erstwhile firm at the time of dissolution. Hence under the provisions of Section 189 also, the assessee was bound to pay the income tax dues of the erstwhile firm. In view of this finding given by the Tribunal, to which no exception has been taken, we find that even otherwise it was not open to the assessee to contend that payment of income tax dues of its predecessor firm may be allowed as a deduction notwithstanding the provisions of Section 40(a)(ii) of the Income tax Act.

11. Accordingly, our answer to the question is in the affirmative i.e. in favour of the revenue and against the assessee.

12. The Reference accordingly stands disposed of.

(M.S. SHAH, J.)

(A.M.KAPADIA, J.)

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